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JURISDICTION AND THE "SITUS" OF DEBTS

Anglo-American courts early developed a body of rules strictly limiting the jurisdiction of courts in cases where one party was a non-resident. These rules were based on the conception that jurisdiction to affect the legal relations of the defendant depended upon physical control over his person. Courts could not act unless the defendant had been personally served within the jurisdiction.[1] It was later recognized

[1] *Buchanan v. Rucker* (1808, K. B.) 9 East, 191; *Schibsby v. Westenholz* (1870) L. R. 6 Q. B. 155; *Pennoyer v. Neff* (1877) 95 U. S. 714; *Freeman v. Alderson* (1886) 119 U. S. 185, 7 Sup. Ct. 165; *McEwan v. Zimmer* (1878) 38 Mich. 765; *Hildreth v. Thibodeau* (1904) 186 Mass. 83, 71 N. E. 111; *D'Arcy v. Kethum* (1850, U. S.) 11 How. 165 (judgment obtained against two partners,

by statute that when the non-resident owned physical objects located within the state his right in such objects could be reached on substituted service provided some reasonable method was adopted.[2] The exercise of jurisdiction by the courts where there is a "res" within the state grew out of the idea that the state has control over all things within its borders, and that it may be assumed that the defendant will keep in touch with his property. Consequently, courts have hesitated to allow substituted service where there is no physical thing within the state. But a strict application of these rules often works hardship and it has been found necessary to adapt the rules to the exigencies of the situation. A number of expedients have been resorted to in order to bring this about. One of these—the introduction of a fiction of consent to the exercise of jurisdiction—was recently discussed in the pages of this journal.[3] Another consists in discovering a "res" within the state where none in fact exists. For this purpose legal relations are reified, hypostatized, *i. e.* treated as if they were physical things within the state. For example, in cases dealing with divorce the "matrimonial status" is treated as a "res" over which the courts of the state in which one of the parties is domiciled have jurisdiction.[4] The slightest analysis reveals

one of whom was absent from the jurisdiction and was not served with process, is invalid and cannot be enforced against the absentee). ". . . it is not competent for a state court to render judgment in personam against a person who is not a resident of the state, who does not appear in the suit, and who is not served personally with process within the state." Morton, C. J., in *Eliot v. McCormick* (1887) 144 Mass. 10, 10 N. E. 705. A statute authorizing service by publication in actions *in personam* when the defendant is not domiciled within the state is unconstitutional as a violation of the due process clause of the fourteenth amendment to the Federal Constitution. See *Pennoyer v. Neff, supra.*

[2] ". . . the state has jurisdiction over property within its limits owned by non-residents, and may, therefore, subject it to the payment of demands against them of its own citizens; and the inquiry can then proceed only so far as may be necessary for the disposition of the property." Field, J., in *Freeman v. Alderson, supra* note 1. They cannot determine any demand beyond that which is satisfied by the property. *Cooper v. Reynolds* (1870, U. S.) 10 Wall. 308. See Beale, *The Jurisdiction of Courts over Foreigners* (1913) 26 HARV. L. REV. 193, 283. As a result of the idea that equity acts only *in personam* courts have hesitated to decree specific performance of a contract to convey land where the defendant is absent from the jurisdiction. *Silver Mining Co. v. Dickert* (1904) 31 Mont. 488, 78 Pac. 967. But where there is a statute authorizing service by publication in such cases, courts exercise jurisdiction, and hold that the action is "quasi-in rem." *Tennant's Heirs v. Fretts* (1910) 67 W. Va. 569, 68 S. E. 387 (bill to remove cloud on title); *Telfair v. Telfair* (1804, S. C.) 2 Desauss. 271 (bill to obtain specific performance of a contract to convey land); *Bush v. Aldrich* (1918) 110 S. C. 491, 96 S. E. 922; *Single v. Scott Paper Mfg. Co.* (1893, C. C. N. D. Ohio) 55 Fed. 553.

[3] COMMENTS (1925) 34 YALE LAW JOURNAL, 415.

[4] Courts seem to be agreed that a state can grant a divorce when one of the parties is absent from the jurisdiction. See *Atherton v. Atherton* (1901) 181 U. S. 155, 21 Sup. Ct. 544. The only question is whether the decree is entitled to recognition under the full faith and credit clause of the Federal Constitution. *Haddock v. Haddock* (1906) 201 U. S. 562, 26 Sup. Ct. 525 (decree granted in

that if this language is taken at its face value the logical fallacy of hypostatization is committed. At most, the statement can be only a more or less convenient mode of stating a result which has been reached on grounds of social expediency, and not a reason for that result.

Greater difficulty arises when there is only a debtor-creditor relationship. The belief of the courts that there must be a "res" within the state, and the difficulty of saying that a debt is such a "res" and so can have a "situs," has led to much confusion in the cases and to a resulting tendency to reify the legal relations wherever the court has decided to exercise jurisdiction.

Thus in the cases of garnishment or foreign attachment courts were at first puzzled as to where the debt should be garnisheed. Some writers take the view that the debtor should not be garnisheed unless his creditor is also within the state, because the debt, being non-physical, can have no "situs."[5] The Supreme Court of the United States finally held, however, that a debtor could be garnisheed wherever he could be found.[6] The justification for permitting this would seem to be that the state where the debtor is, is the only practical and convenient place to allow garnishment if it is to be allowed at all. The result thus reached on grounds of expediency may be and often is expressed by saying that for garnishment purposes the "situs" of the debt is the state where the debtor is. If we use this language we must then guard ourselves

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state not the matrimonial domicile is not entitled to recognition in another state). *Perzel v. Perzel* (1891) 91 Ky. 634, 15 S. W. 658; *Burlen v. Shannon* (1874) 115 Mass. 438 (decree granted in state in which plaintiff had a *bona fide* domicile is entitled to recognition in other states). See, Richards, *Full Faith and Credit Clause of the Federal Constitution as Applied to Suits for Divorce* (1920) 15 ILL. L. REV. 259; NOTES (1917) 31 HARV. L. REV. 489.

[5] It has been held that the "situs" of a debt for garnishment purposes is at the domicile of the creditor. *Green v. Farmers' and Citizens' Bank* (1857) 25 Conn. 452; *Ill. Central R. R. v. Smith* (1893) 70 Miss. 344, 12 So. 461; *Louisville & Nashville R. R. v. Nash* (1898) 118 Ala. 477, 23 So. 825; see, *Central Trust Co. of N. Y. v. Chattanooga R. & C. Ry.* (1895, C. C. E. D. Tenn.) 68 Fed. 685; Beale, *The Exercise of Jurisdiction in Rem to Compel Payment of a Debt* (1913) 27 HARV. L. REV. 107. Some courts have said that it must be at the domicile of the debtor. *Newland v. Reilly* (1891) 85 Mich. 151, 48 N. W. 544; *Bragg v. Gaynor* (1893) 85 Wis. 468.

[6] *Harris v. Balk* (1904) 198 U. S. 215, 25 Sup. Ct. 625 (judgment is binding in other states under the full faith and credit clause of the Federal Constitution if notice has been sent the creditor). The case of *Chicago, Rock Island Ry. v. Sturm* (1899) 174 U. S. 710, 19 Sup. Ct. 797, shows the tendency to reify the legal relations. The courts said: "Whatever of substance there is must be with the debtor. He and he only has something in his hands. That something is the *res*, and gives character to the action as one in the nature of a proceeding *in rem*." *Kansas City P. & G. Ry. v. Parker* (1901) 69 Ark. 401, 63 S. W. 996; *Burlington & M. Ry. v. Thompson* (1884) 31 Kan. 180; NOTES (1923) 8 CORN. L. QUART. 378; (1923) 21 MICH. L. REV. 938; COMMENTS (1924) 33 YALE LAW JOURNAL, 877; Carpenter, *Jurisdiction Over Debts for the Purpose of Administration, Garnishment, and Taxation* (1918) 31 HARV. L. REV. 905; see NOTES (1923) 37 HARV. L. REV. 387.

against reversing the proposition and saying that garnishment may be had in the state of the debtor because that is the "situs" of the debt.[7]

The question has arisen whether jurisdiction will be exercised where merely a debtor-creditor relationship is involved and there are two or more persons each claiming to be the creditor, one of whom is a non-resident and absent from the jurisdiction. As a result of the idea that there must always be a "res" within the jurisdiction, courts have disagreed as to whether jurisdiction should be exercised, and the cases even within one state are difficult to reconcile.[8] In an action by the trustee of an estate against a foreign insurance company authorized to do business within the state, and several non-resident claimants, for the recovery of the amount due on the insurance policy, the New York Court of Appeals held that service by publication was sufficient as against the non-resident claimants and therefore that they would be bound by the court's adjudication of their legal relations.[9] Here again the ostensible reason for the decision was that "the action" was "one to define and enforce an interest in specific personal property within the state." Thus the court found a "res" within the state. But in *Schoenholz v. New York Life Ins. Co.,*[10] an interpleader proceeding involving a similar situation, the same court later refused to exercise jurisdiction as there was no "res" within the state. The difficulty obviously arises from the attempt of the court to find a "res" within the state and its unwillingness to exercise jurisdiction unless such a "res" can be discovered, coupled with the tendency to reify legal relations in order to satisfy the supposed requirement.

That in the debtor-creditor cases there is in fact no "res" or thing

[7] Powell, *Business Situs of Credits* (1922) 28 W. VA. L. QUART. 89.

[8] The problem of interpleader has been very fully discussed by Chafee, *Interstate Interpleader* (1924) 33 YALE LAW JOURNAL, 685. In *Stevenson v. Anderson* (1814, Ch.) 2 Ves. & B. 407, Lord Eldon, holding that the resident plaintiff should send notice to the absent claimants asking them to interplead, intimated that if they did not do so they would be bound by the suit. The life insurance policy cases have raised an interesting problem and courts are not entirely agreed as to whether jurisdiction should be exercised where some of the claimants are absent from the jurisdiction. Some American courts have not exercised jurisdiction because no "res" could be found within the state. *Cross v. Armstrong* (1887) 44 Ohio St. 613, 10 N. E. 160; *Hanna v. Stedman* (1921) 230 N. Y. 326, 130 N. E. 566; (1921) 30 YALE LAW JOURNAL, 860; *Schoenholz v. New York Life Ins. Co.* (1921, 1st Dept.) 197 App. Div. 91, 188 N. Y. Supp. 596; *Dexter v. Lichter* (1904) 24 App. D. C. 222; *Fed. Life Ins. Co. v. Looney* (1913) 180 Ill. App. 488; *Gary v. Northwestern Masonic Aid Assoc.* (1893) 87 Iowa, 25, 53 N. W. 1086. But it has been held that interpleader should not be denied and that the court has jurisdiction. *Perry v. Young* (1913) 133 Tenn. 522, 182 S. W. 577; NOTES (1916) 16 COL. L. REV. 414; COMMENTS (1916) 27 YALE LAW JOURNAL, 252; *Amparo Mining Co. v. Fidelity Trust Co.* (1908) 74 N. J. Eq. 197, 71 Atl. 605; *Kelly v. Smith* (1912, C. C. A. 7th) 196 Fed. 466.

[9] *Morgan v. Mutual Benefit Life Ins. Co.* (1907) 189 N. Y. 447, 82 N. E. 438.

[10] *Schoenholz v. New York Life Ins. Co., supra* note 8; COMMENTS (1922) 31 YALE LAW JOURNAL, 425; NOTES (1922) 22 COL. L. REV. 152.

within the state is emphasized by the decisions which assert that usually for taxation purposes the "situs" of the debt is the domicile of the creditor.[11] On the other hand, for the purposes of administration the "situs" of the debt is held to be at the domicile of the debtor.[12] As has been well said by Prof. T. R. Powell, "situs" really is only a "tag for a result" and should be taken "as a verbal sign for the place where a debt or chose in action may be effectively dealt with" for the particular purpose in view. If this is kept in mind it would seem that the test should be whether, from a practical standpoint, the exercise or non-exercise of jurisdiction in the particular case works substantial justice to the parties, all things considered.[13] Arguments have been advanced by some writers against the advisability of allowing the courts to exercise jurisdiction in interpleader cases, as well as in garnishment cases, where one or more parties are non-residents, and absent from the jurisdiction. The opportunity for fraud thus afforded to persons having unfounded claims is one of the most important objections. Another is the injustice to the non-resident defendant in being required to travel a great distance to defend a claim and the probability that he will suffer judgment by default rather than go to so great an expense to defend. It has also been advanced that in garnishment cases it is unfair to the non-resident to permit service by publication wherever the garnishee can be found because his creditor cannot know where the garnishee is at all times.[14]

Against these considerations must be placed the injustice that would often result to the plaintiff in a given case if he can never determine his legal relations until all of the parties are within one jurisdiction. Because of this injustice the Supreme Court of the United States, as has been pointed out, in the garnishment cases, has held that the debtor may be garnisheed wherever he may be found regardless of whether his creditor is within the state. It has been argued that this should be considered an exception to the normal rule and strictly limited. There seems to be no substantial reason why in cases where a similar injustice would result the court should not, after taking into account all the

[11] A creditor may be taxed at the state of his domicile on all debts due him. *State Tax on Foreign Held Bonds* (1872, U. S.) 15 Wall. 300; *Scripps v. Board of Review of Fulton County* (1899) 183 Ill. 278, 55 N. E. 700 ("the debt follows the residence of the creditor and has its situs there"); see Beale, *Jurisdiction to Tax* (1919) 32 Harv. L. Rev. 587. See also Notes (1918) 7 Calif. L. Rev. 117 (situs of stock for purpose of taxation); Beale, *Taxation of Foreign Corporations* (1903) 17 Harv. L. Rev. 248; Powell, *Business Situs of Credits, supra* note 7.

[12] *Barrett v. Barrett's Adm'r* (1916) 170 Ky. 91, 185 S. W. 499. See Beale, *Jurisdiction in Rem to Compel Payment of a Debt, supra* note 5; Carpenter, *Jurisdiction over Debts for the Purpose of Administration, Garnishment, and Taxation, supra* note 6.

[13] Powell, *Business Situs of Credits, supra* note 7.

[14] Beale, *Jurisdiction in Rem to Compel Payment of a Debt, supra* note 5 at p. 121.

advantages and disadvantages and balancing the considerations, assume jurisdiction if it sees fit to do so. In the recent case of *Redzina v. Provident Inst. for Savings in Jersey City*,[15] however, the court was influenced by the old notion that jurisdiction depends upon physical control or the presence of a "res" within the state. In that case a husband and wife had opened a joint saving account. No money could be drawn from the bank unless the pass book was presented. Later the wife disappeared and the pass book could not be found. The plaintiff, husband, upon refusal of the bank to pay the money to him, brought a bill to force the defendant bank to do so. The wife was served by publication as provided by statute. The court held that there was no "res" within the state and therefore service by publication was unconstitutional and the court had no jurisdiction. The conclusion of the court was that service by publication is based upon the assumption that owners of property keep in touch with what is published where it is situated and that it would be unfair to require the non-resident to follow the whereabouts of the debtor. Although this might be true in some cases, in the instant case the debtor is a savings bank permanently located within the state, and is unlikely to leave the state. It should also be noted that the instant case differs from the interpleader cases in that both parties have a valid claim to the money and either is entitled to the whole amount. Moreover, in view of the fact that it has been held that the bank may waive the requirement that the pass book be presented and so may pay the whole to one party thus extinguishing the claim against it,[16] it would seem that the court might well have exercised jurisdiction in the instant case. The unfortunate result reached seems to be that the plaintiff may never be able to recover his money. The possible injustice that might result to a non-resident claimant if jurisdiction were permitted in such a case as this would seem to be more than offset by the injustice which results to the plaintiff upon refusal to exercise jurisdiction.

THE RIGHTS OF NON-CUMULATIVE PREFERRED STOCKHOLDERS IN UNDIVIDED PROFITS

It has been usual for the courts to say that the holder of non-cumulative preferred corporate stock loses with the close of each fiscal period all interest in profits that have accrued but remain undivided during such period.[1] It is well settled that division of profits is a matter for

[15] (1924, N. J. Eq.) 125 Atl. 133.

[16] *Brooks v. Erie County Savings Bank* (1915, 4th Dept.) 169 App. Div. 73, 154 N. Y. Supp. 692. By-law requiring presentation of pass book must be construed reasonably. *Mills v. Albany Exch. Sas. Bank* (1899, Sup. Ct. Tr. T.) 28 Misc. 251, 59 N. Y. Supp. 149.

[1] *Burke v. Ottawa Gas & Electric Co.* (1912) 87 Kan. 6, 123 Pac. 857; *Hazeltine v. B. & M. L. Ry.* (1887) 79 Me. 411, 420, 10 Atl. 328, 332. See also 1 Cook,

the discretion of the directors and that a court will compel a declaration of dividends only when such discretion is exercised in bad faith.[2] On the face of it, a contract in which the promisee's rights are conditional upon the accrual of profits in such an amount as in sound business judgment warrants division is not an unreasonable contract; but let us see how such a contract will actually work out in the business world and what the courts, faced by its working, have actually done as distinguished from what they have said.

The buyer of preferred stock is ordinarily a mere investor. The courts applying legal criteria, and the general public, thinking in terms of an economics worked out in the infancy of industrialism, and misled by the label "shareholder," have been accustomed to regard him as what the economists would call a co-entrepreneur. That he is not such in any real sense seems abundantly clear. Functionally considered from the point of view of the buyer, preferred stock is a device for getting a higher return on capital than can be obtained by investing in bonds, while at the same time retaining as *much* as possible of the bondholder's security. In construing the contract the preferred stockholder makes, this fact must be constantly borne in mind. The circumstances attendant upon its issue further evidence the true nature of preferred stock: it is issued by "going concerns" to finance contemplated expansions or to raise money to tide over difficult periods; it is issued upon reorganization of insolvent corporations in exchange for outstanding bonds; it is sold to the investing public in the promotion of new enterprises. In all these cases the preferred stock may be, and frequently is, issued voteless and with the privilege and power of retirement by the corporation.[3] Such provisions, it seems, make the economic function of preferred stock perfectly clear.

The entrepreneur of the classical economists, uniting in himself the functions of promotion, control, management, and ownership, is no longer typical. The real work of promotion is now generally carried on by specialists—brokers and underwriting banks—in the employ of the

Corporations (8th ed. 1923) 920: ". . . the courts are inclined to scan closely a refusal to declare dividends where there are net profits and where the preferred stock is non-cumulative." Likewise a similar statement in 1 Morawetz, *Private Corporations* (2d ed. 1886) sec. 459. The rationale of these statements seems clear.

[2] *St. John v. Erie Ry.* (1874, U. S.) 22 Wall. 136; *N. Y., L. E. & W. Ry. v. Nickals* (1886) 119 U. S. 296, 7 Sup. Ct. 209; *Storrow v. Texas Consolidated Compress & Mfg. Assoc.* (1898, C. C. A. 5th) 87 Fed. 612.

[3] Under the avowed rule it would seem that where such privilege is provided for, the stock might under some circumstances, when non-cumulative, be retired without the shareholder having received any return at all on his money although the corporation might have profited greatly from the use thereof—as where after a long period in which dividends are omitted in order to build up a working capital reserve, a "bumper" year enables the corporation to retire the preferred stock. But whatever the rule avowed by a court, it seems certain that it would find some pretext for protecting a plaintiff in such circumstances.

element which, for the present purpose, may be termed the "controller"[4] of the corporation. It is the "controller," also, who, at a later stage of the enterprise, employs the laborers and the managers and it is he who hires the capital—hires persons to own the enterprise. Functionally considered from his point of view, preferred stock is often merely a device for separating more effectually the control of the enterprise from its ownership while giving as *little* as possible of the bondholder's security. Whether or not the preferred stock is voteless, the "controller" will always be careful to retain in his hands enough common stock to control the enterprise. Such common stock is theoretically not "water," but in practice it is likely to be so in part; for the "controller" will take for his services in organizing the corporation as much as can possibly be taken within the requirement of "good faith." As the enterprise gets under way, any "water" that may exist is gradually absorbed by the accrual of profits that remain undivided, by the upbuilding of "good will," and by the increasing capital value of the organization as a "going concern." But whether there is originally any "water" or not, it is manifestly to the interest of the "controller" as owner of at least fifty-one per cent. of the common stock to extinguish the interest of non-cumulative shareholders in accruing profits. Frequently his only objective for the enterprise is so to manipulate it as to raise the market value of his shares to a point at which he can sell out at a handsome profit; and the sooner this point is reached, the sooner he can step out to repeat the process with another enterprise.

The non-cumulative shareholder, voteless or outvoted, with only the flimsy protection of the legal requirement of "good faith"[5] between

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[4] The "controller" is fifty-one per cent. of the common, or voting stock. He may be an individual or a group, the members of which are in agreement between themselves as to the policy to be pursued. The "controller" may have retained control at the time of organization or he may have bought control in the open market or the control element may have "crystallized" out of the corporate membership; but in any case the "controller" is pretty certain to emerge as a well-defined unit in the economic process—a unit with power concentrated in his hands and with interest, in so far as the division of economic income is concerned, adverse to all the other elements in that process including capital. In the face of this phenomenon the classical economic theory as to the tripartite competitive division of income into rent, wages, and profits breaks down. The inadequacy of the classical theories to describe present-day economic phenomena is discussed in Veblen, *Absentee Ownership and Business Enterprise in Recent Times* (1923) *passim.*

[5] The difficulties of proving "bad faith" are notorious. And it seems that it cannot exist as long as the retention of profits can be shown to be in the best interest of the corporation. Even extensive expansions at the expense of the non-cumulative shareholder are consistent with "good faith" although under the avowed rule it would seem that the only possibility of gain therefrom for him is in the greater probability that dividends will be earned in future years, which dividends, however, may never be declared. *St. John v. Erie Ry., supra* note 2. Another case permits only those expansions demanded by the public interest. *Burke v. Ottawa Gas & Electric Co., supra* note 1.

him and the adverse interest of the "controller," is practically at the latter's mercy if he has no permanent rights in accruing profits. It is quite conceivable that sound business policy might compel the "controller" of a corporation to withhold accruing profits from division for a score of years and it seems clear that the law should accord him the privilege of so doing;[6] but it seems equally clear that sound public policy demands that the "controller" shall not be in a position by the exercise of that privilege to profit at the expense of the non-cumulative shareholder. And policy apart, it is unreasonable that such should be the result of the exercise of the privilege. Not, it may be urged, if the non-cumulative shareholder contracted on those terms. But waiving the objection that such an argument begs the question, it cannot be denied that such shareholders contract for some sort of preference over the common stockholders by the express terms of their contract. To hold that withholding division of accrued profits divests their interest in such profits is to make their preference illusory—to accord the real preference to the common stockholders, and so, to the "controller"; for, assuming that the privilege of withholding will be exercised, as it will, realistically viewed, the avowed rule gives the common stock a preference over the preferred to the amount that may be withheld in "good faith." Hence it is that the construction that the courts have said they put upon the non-cumulative shareholder's contract is essentially unreasonable.

The problem presented to the courts in determining the rights of non-cumulative shareholders in undivided profits is, as in so many modern cases, essentially one of preserving a proper balance between the various elements in the economic process in their competition for income.[7] There seems to be not a single case directly establishing the existence of the avowed rule. The nearest approach to an authority for this rule is found in those cases in which the courts have used the rule as a premise from which to deduce the existence in the shareholder of a right, regardless of the existence of "bad faith," to compel division of accruing profits.[8] But these cases seem to be unsound as

[6] Of course control sometimes falls into the hands of those ignorant or careless of the needs of the enterprise; but the requirement of "good faith," being an objective one, is supposed to take care of such exigencies.

[7] The question is not as to whether the "controller" performs a really valuable service in the economic process. That his service may be of the utmost value will be conceded. The real problem is to prevent the "controller," with power concentrated in his hands, from getting more than his fair share of economic income.

[8] *Burke v. Ottawa Gas & Electric Co., supra* note 1; *Hazeltine v. B. & M. Ry., supra* note 1. In the latter case it was held that there was a forthright promise to divide all profits semi-annually; but though the right to dividends was not made expressly conditional upon declaration by the board of directors, it would seem that in accordance with sound policy such a condition should always be implied although in the *Hazeltine* case such a condition would, seemingly, not have affected the result.

encroachments on the discretion of the directors ("controller") in the control of the enterprise. Generally, however, this discretion is upheld and suits to compel division denied.[9] Such cases are silent as to the possibility of non-cumulative shareholders having continuing equitable rights in the withheld profits. If such rights were generally recognized, no encroachment upon the discretion of the board of directors would be necessary. There are a few cases recognizing such rights; but in all of them there is more or less reliance on some special provision of charter or statute as determinative of the result,[10] although the provisions relied upon in some cases are of such doubtful meaning as to raise the suspicion that the same rights would have been recognized in their absence.

Two recent New Jersey cases are the latest to recognize such rights in non-cumulative shareholders. The defendant corporation in these cases had in previous years earned profits sufficient for dividends on both non-cumulative preferred and common stock, but the funds so earned had been withheld and transferred to a "working capital reserve fund." In 1922, after having paid on the non-cumulative stock the preference dividend of seven per cent., the board of directors voted to pay thereon an additional dividend of one-half of one per cent. and a dividend of the same per cent. on the common stock, in each case reciting that the dividend so declared was paid from funds accumulated by withholding past earned but undivided profits from the particular class of stock-

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[9] *Supra* note 2.

[10] In *Wood v. Lary* (1888, N. Y. Sup. Ct. App. T.) 47 Hun, 550, a common stockholder sued to enjoin a "lump" payment to non-cumulative stockholders of four years' dividends where profits sufficient to pay the omitted dividends had accrued in the corresponding years. The injunction was denied. The court, relying on the charter (". . . entitled to dividends . . . not cumulative . . . whenever in any year the net earnings, after payment of all interest charges, shall suffice for the payment thereof") regarded the language as a forthright promise to divide semi-annually; but the decision turns on the force of the word "suffice" and clearly the court might have found in this word an implied condition of sufficiency in accord with sound business policy. In *Bassett v. U. S. Cast Iron P. & F. Co.* (1909) 75 N. J. Eq. 539, 73 Atl. 514, a common stockholder sued to restrain payment of a dividend to the non-cumulative preferred stockholders from moneys accumulated in past years by withholding profits from such stockholders on the ground that all undistributed profits "belonged" to common stockholders after the close of each fiscal period. The injunction was refused, but despite the contention of the corporation that it might use any and all surplus net profits to pay preferred dividends, the court said that only moneys accumulated by withholding profits from preferred stockholders might be so used. The position taken by the court is noteworthy in view of the charter provision that ". . . the preferred stock shall be entitled *out of any and all surplus net profits*, whenever declared by the board of directors, to non-cumulative dividends . . ." In *Continental Insurance Co. v. M. St. P. & S. S. M. Ry.* (1922, D. Minn.) 283 Fed. 276, affd. (1923, C. C. A. 8th) 290 Fed. 87, affd. (1923) 263 U. S. 703, 44 Sup. Ct. 33, accrued but undivided profits were held, in accordance with stock certificate and consolidation articles to be ear-marked for the shareholders who would have received dividends, had the profits been divided.

holders then being paid. In *Moran v. United States Cast Iron Pipe & Foundry Co.*,[11] a common stock holder, while conceding that under the doctrine of a previous New Jersey case[12] moneys accumulated by withholding division of accrued profits could be used subsequently to pay dividends only on that stock from which such profits had in the first instance been withheld, nevertheless sought to restrain payment of the additional dividend to the preferred stockholders on the ground that the charter provisions prohibited payment to such stockholders of anything beyond their seven per cent. preference in any one year. In other words, it was urged in limitation of the former decision, that under it profits withheld from the preferred stockholders were available subsequently only for making up deficiencies in "lean" years in the seven per cent. preference. The injunction was denied by the vice-chancellor in an able opinion in which, at the same time, he granted an injunction to a preferred stockholder who had sued to enjoin any payment at all to common stockholders until all profits withheld in previous years from preferred stockholders had first been declared and distributed to them. In the Court of Errors and Appeals, the first decision was unanimously affirmed[13] on the vice-chancellor's opinion, but only an equal division of the court saved the latter decision from reversal in *Day v. United States Cast Iron Pipe & Foundry Co.*[14] The judges voting for affirmance relied on the statute[15] as controlling, but the other members of the court reached their result in spite of it—a fact which, in view of the statutory provisions, is striking evidence of the strength of the belief in the supposed rule.

It seems clear from the foregoing not only that what has usually been regarded as the rule is unsound as being out of touch with the realities of modern business, but also that it is totally unsupported by authorities. The failure of the courts up to now frankly to avow what seems to be the real rule is to be explained, it is believed, in part by the persistence of the notion that shareholders are necessarily co-entrepreneurs. This we have seen is fallacious. The other obstacle in the way of recognition of the real rule is believed to be this, that the word "non-cumulative" has been commonly taken as a negation of all that the word "cumulative" stands for without analyzing just how such a negation operates.

It is said that a corporation holds its property in trust for the indivi-

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[11] (1924) 95 N. J. Eq. 389, 123 Atl. 546.

[12] *Bassett v. U. S. Cast Iron P. & F. Co. supra* note 10.

[13] (1924, N. J. Eq.) 126 Atl. 329.

[14] (1924, N. J. Eq.) 126 Atl. 302.

[15] The statute provided: ". . . the holders thereof shall be entitled to receive, and the corporation shall be bound to pay thereon, a fixed yearly dividend, to be expressed in the certificate, not exceeding eight per centum, payable quarterly, half-yearly, or yearly, before any dividend shall be set apart or paid on the common stock and such dividends may be made cumulative . . ."

dual shareholders.[16] In accordance with this statement and in description of shareholders' rights in undivided profits as recognized in the decided cases, it seems proper to say that accruing profits come into the hands of the corporation impressed with a trust in favor of the shareholders who would be entitled to receive them, were they then divided. The norm is the corporation with only one class of shareholders. In such a concern the stockholders take their equitable interests in accruing profits in proportion to their holdings. Before the accrual of such profits the stockholder has merely an expectant interest analogous to the expectancies of the law of real property. After their accrual he is the beneficiary of a trust, whose *res* is the undivided profits and whose terms are settled by the law of corporations and the contract between the parties. The expectant interest of the common stockholder, as the norm, is that given by the law as an incident of the shareholder relationship when the nature of the expectant interest of the shareholder is not the subject of express contract. To designate shares as "preferred," "cumulative," "non-cumulative," and so on is to contract expressly as to the nature of this expectant interest in profits not yet in *esse*. The *cumulative* preferred stockholder has during the first year an expectant interest in that fraction of the first year's profits which equals the promised per centum of his holdings—say seven per cent. If profits are earned, this expectant interest becomes actual and immediate;[17] if not, it continues merely expectant, and during the second year such stockholder will have an expectant interest in the second year's profits equal to fourteen per cent. of his holdings; and if in the second year there are likewise no profits, then in the third year he will have an expectant interest equal to twenty-one per cent., and so on. In other words, his *expectant* interests for the various years *accumulate*, when they are not realized, and it should be noted that, although they are realized as actual and immediate equitable interests in undivided profits, these latter relapse to mere expectant interests if the profits—the subject matter of the equitable interest—are lost through the chances of the enterprise, and continue as such until again realized. The expectant interest of *non-cumulative* shareholders differs from that of the *cumulative* shareholder only in this, that the expectant interests of

[16] 1 Morawetz, *op. cit.* sec. 237. Of course this is merely a conveniently abbreviated way of describing a complicated species of ownership of property to which individuals sometimes find it expedient to resort. See Hohfeld, *Nature of Stockholders' Individual Liability for Corporation Debts* (1909) 9 Col. L. Rev. 285.

[17] Not, of course, in the sense that there is an immediate, unconditional right that the corporation shall pay him dividends. See *supra* note 2 and correspondent text. The interest "expected" was the beneficial "end" of a trust relationship with the corporation the trustee. With the accrual of profits—the coming into existence of the trust *res*—all those legal relations which go to make up that jural aggregate we call a trust become immediately enforceable. For an able and detailed discussion of the relations going to make up this aggregate in the case of the non-cumulative shareholder, see Berle, *Non-Cumulative Preferred Stock* (1923) 23 Col. L. Rev. 358.

the former for the various years never accumulate: they must be realized, if at all, out of profits for the corresponding years.[18]

It thus appears that a preference, in its relational aspect, is an expectant equitable interest in profits not yet in *esse*, variant from the normal in a manner expressly provided by the terms of the contract between the parties;[19] and the particular variation from the normal denoted by the word "cumulative" is that in which the expectant equitable interests for the various years accumulate as described above. It is this accumulation of expectant interests (or preferences) that is negatived by the word "non-cumulative."[20] But because the "right to arrearages" for

[18] The statement that the non-cumulative shareholder's expectant interests for the various years cannot accumulate—that they must be "realized" out of profits for the corresponding years—obviously precludes the reappearance of such expectant interests, as in the case of cumulative stock, upon the loss of withheld profits through the chances of the enterprise.

[19] A common variant from the normal mode of taking equitable interests in accruing profits is that of giving preferred stockholders the "right" (really an expectant interest) to participate in profits equally with common stockholders after the preference dividend has been paid to the former, or provided for, and after a dividend of the same per cent. has been paid to the common stockholders, or provided for. It seems clear that wherever the "right" to participation exists, the common stockholder has a secondary preference equal in per centum to the primary preference of the preferred stockholder, and after the latter has been paid his preference or after it has been provided for, the common stockholder, as to his secondary preference to further profits, is in the position of the ordinary non-cumulative preferred stockholder as to first profits. This seems to have been recognized on the ground of express charter provision in *Continental Insurance Co. v. M. St. P. & S. S. M. Ry., supra* note 10; and see *Bassett v. U. S. Cast Iron P. & F. Co., supra* note 10. In several cases denying cumulative rights to such common stockholders, the insistence of the court that the dividends sued for had neither been *earned* nor declared seems to indicate that non-cumulative rights were recognized. *Englander v. Osborne* (1918) 261 Pa. 366, 104 Atl. 614; *Lockwood v. General Abrasive Co.* (1924, 4th Dept.) 210 App. Div. 141, 205 N. Y. Supp. 511. Some courts hold the right to participation exists in all preferred stockholders unless explicitly negatived by contract. *Sternbergh v. Brock* (1909) 225 Pa. 279, 74 Atl. 166; *contra: Niles v. Ludlow Valve Mfg. Co.* (1912, S. D. N. Y.) 196 Fed. 994, affd. (1913, C. C. A. 2d) 202 Fed. 141.

[20] Despite the fact that the contract is often expressed by saying that the preferred stock shall be entitled to "cumulative dividends" or "non-cumulative dividends," it is nevertheless maintained that these adjectives have no proper reference to the "accumulation of dividends" but only to the accumulation of preferences or expectant interests. Much of the uncertainty in the law of non-cumulative stock has no doubt been the result of such loose forms of expression. See the language of the New Jersey statute, *supra* note 15. If these adjectives do have proper reference to the "accumulation of dividends," then without explicitly contracting for it every common stockholder gets this "right to receive" back-profits which the non-cumulative preferred stockholder does not. This is an unreasonable result for the "right to receive" back-profits makes the probability of income higher for the common than for the preferred stockholders, whereas it is generally understood that the preferred stockholder foregoes the "right to vote" and usually the "right to participation" in return for greater assurance of a stipulated return.

all years is the most striking of the relations[21] making up the cumulative shareholder's interest, it has been easy to reason that where "cumulative rights" are negatived there can be no "right to arrearages" at all. But this is manifestly erroneous—if "right to arrearages" means only the "right to receive" dividends earned in one year in another year subsequent thereto, or a "right to receive" several years' profits in a "lump" dividend—for even a common stockholder may receive "lump" dividends and yet it is never objected that he is then getting "cumulative rights." Payment to non-cumulative stockholders of arrearages made up of past earned but undivided profits no more involves a recognition of "cumulative rights" in such shareholders than does the payment of "lump" dividends to common stockholders.

Yet the proposition that non-cumulative dividends, once passed, are forever lost is repeatedly encountered in the cases either in express form or as an "inarticulate major premise." Manifestly the logic is at fault; but it seems clear that the persistent belief that this rule exists is to be ascribed very largely to a faulty analysis of the negation contained in the world "non-cumulative." The New Jersey cases, discussed above, are unquestionably sound, but it does seem unfortunate that there was in them any reliance on charter or statute. The law of non-cumulative stock needs the clarifying effect of a few decisions "on principle." Even in the absence of a pertinent statute the most explicit sort of language should be required in the charter, by-laws, or stock certificate to negative the existence in the non-cumulative shareholder of equitable rights in undivided profits to the extent of his preference. It is even doubtful that sound public policy should ever permit a corporation to make a contract denying them.[22]

MODERN VIEWS OF THE ELECTION OF REMEDIES

Because of its harsh operation the doctrine of election of remedies (that resort to one remedy bars later resort to one inconsistent with it) has received much unfavorable notice in recent years.[1] In many cases

[21] The "right to arrearages" is, of course, a jural aggregate; not a simple legal relation.

[22] In this connection it is worthy of careful notice that despite the explicit charter provisions to the contrary, the court in the *Bassett* case, *supra* note 10, denied the "right" of the preferred stockholders to receive dividends "out of any and all surplus net profits" and recognized the equitable interest of the common stockholders in all moneys accumulated by withholding from them dividends in former years.

[1] See Hine, *Election of Remedies, a Criticism* (1913) 26 HARV. L. REV. 707; Deinard and Deinard, *Election of Remedies* (1922) 6 MINN. L. REV. 341, 480. "No matter what may be thought of the merit of the doctrine of election of remedies, it is a long observed and deeply intrenched rule of procedure. But, for obvious reasons, it has never been a favorite of equity . . . At best this doctrine of election of remedies is a harsh and now largely obsolete rule, the

the rule prevents an injured but ill-advised plaintiff from recovering against an admittedly guilty but well-advised defendant.[2] Under modern codes of procedure the doctrine is anomalous; forms of action have been abolished and a plaintiff now receives whatever relief he can show a right to, no matter how inconsistent his pleadings.[3] While some code states have struggled to abandon the doctrine as antiquated, others uphold it as a fundamental principle of practice.[4] The recent case of *Frederickson v. Nye* (1924) 110 Ohio. St. 484, 144 N. E.[5] 299, shows that the Supreme Court of Ohio, though making an effort to avoid the highly technical results reached in its earlier decisions, is still committed to the election of remedies as a rule of code pleading. It is believed that an examination of the case will indicate that the plaintiffs had done no act which properly constituted an election, and that even assuming such an act the remedies sought by them were not under the code so inconsistent as to justify denial of recovery.

Six months before the commencement of the present suit the plaintiffs had brought an action for damages alleging the same facts, with an averment that the property in dispute belonged to the defendants. On giving an injunction bond they obtained in that action an order restraining the defendants from disposing of the property. Their motion for a receiver was denied. Four months later, under the provisions of the Ohio General Code,[6] they dismissed their damage suit without prejudice at their costs. The injunction was then dissolved. Shortly thereafter the defendants conveyed the property to Frederickson, who, it was

scope of which should not be extended . . . ." Clarke, J., in *Friedrichsen v. Renard* (1918) 247 U. S. 207, 211, 213, 38 Sup. Ct. 450, 451, 452, cited with approval by Beach, J., in *Abbadessa v. Puglisi* (1924, Conn.) 124 Atl. 838. "Finality is now accorded to election with marked hesitation in contradistinction to the view which obtained at the time of the decision in *Terry v. Munger*, 121 N. Y. 161, 24 N. E. 272." Bijur, J., in *Bank of United States v. Nat. City Bank of New York* (1924, Sup. Ct. Spec. T.) 123 Misc. 801, 206 N. Y. Supp. 428. See also Andrews, J., in *Metropolitan Life Ins. Co. v. Childs Co.* (1921) 230 N. Y. 285, 130 N. E. 295.

[2] "We believe that a court of equity cannot award damages in the face of the generally accepted doctrine that one who elects one of two inconsistent remedies must stand or fall by his decision. . . We regret the position we are thus obliged to take, especially in view of the fact as has already been heretofore indicated, the defendants have been guilty of an act of fraud criminal in its nature." *Mueller v. Michels* (1924, Wis.) 197 N. W. 201, 206. "It is proper to observe that in a case where fraud is proved, it will not do for the court to pursue the shadow and refuse to take note of the substance." Dean, J., in *Carson v. Greeley* (1922) 107 Neb. 609, 620, 187 N. W. 47, 51.

[3] See Clark, *Union of Law and Equity* (1925) 25 Col. L. Rev. 1.

[4] "Although the whole genius of code pleading would seem to oppose the retention of a rule founded in outworn formulæ . . . we find the curious rule perpetuated in many decisions under the codes." Deinard and Deinard, *op. cit. supra* note 1, at p. 505.

[5] Two judges dissented.

[6] Sec. 11586.

claimed, had knowledge of the fraud of his grantors. The plaintiffs then brought the present action, seeking to establish a trust in their favor against the original defendants and Frederickson.[7] On appeal to the Supreme Court it was held that the first suit was an action at law in deceit, and the second a suit in equity; that the first was on the theory that the legal title was in the defendants, and the second on the theory that though the legal title was in the defendants, the equitable title was in the plaintiffs. Two such actions, said the court, are inconsistent. The plaintiffs were then held to have elected their remedy as against the original defendants because the injunction secured in the first action was detrimental to the defendants. Final judgment was given for Frederickson, who, since he stood in his grantors' shoes, could avail himself of the election.

In the years when *Terry v. Munger*[8] held the field, this decision would have been considered very advanced, for it goes far beyond the views prevailing in that era. It asserts, and in so doing substantially overrules earlier Ohio cases,[9] that merely beginning a suit is not such a decisive act as to constitute an election.[10] It adopts instead the rapidly growing rule that the party making the election must have caused detriment or loss to the other party or received some benefit under it,[11] or pursued his remedy to final judgment.[12] The court does not in terms accept the most modern view, that an election to be binding must be an estoppel either in pais or of record.[13] Nevertheless the only element of estoppel lacking in its requirements is misleading conduct, which might often

[7] The trial court gave judgment on the pleadings for the defendants. In the Court of Appeals the defendants' motion for judgment on the pleadings was overruled as to Frederickson, but sustained in favor of his grantors. The plaintiffs were awarded damages and the judgment has made a lien on the property. Both the plaintiffs and Frederickson appealed.

[8] *Supra* note 1.

[9] *Lee v. Thoma* (1915) 91 Ohio St. 444, 110 N. E. 1062; *Mignery v. Olmstead, Adm'r* (1915) 91 Ohio St. 416, 110 N. E. 1063; *Drake v. Zutterling* (1910) 82 Ohio St. 410, 92 N. E. 1113 (all memoranda decisions). The court approves *Becker v. Walworth* (1887) 45 Ohio St. 169, 12 N. E. 1.

[10] Beginning suit was held an election in *Belding v. Whittington* (1922) 154 Ark. 561, 243 S. W. 808; *Ireland v. Waymire* (1920) 107 Kan. 384, 191 Pac. 304; *contra: Sauer v. Bradley* (1922) 87 Okla. 277, 210 Pac. 726; *Tracy v. Aldrich* (1921, Mo.) 236 S. W. 347.

[11] *Knowles v. Dark & Boswell* (1924, Ala.) 99 So. 312; *Bell v. Butte Inv. Co.* (1923, Mo.) 250 S. W. 381.

[12] *C. M. Davis & Co. v. Stukes* (1923) 122 S. C. 539, 115 S. E. 814; *Berman v. Apter* (1920) 95 Conn. 66, 110 Atl. 453.

[13] *Roullard v. Rosenberg Bros. & Co.* (1924, Calif.) 224 Pac. 449, 451; *Huffman v. Bankers' Automobile Ins. Co.* (1924, Neb.) 199 N. W. 716; *Crutcher v. Eaves* (1924, Tex. Civ. App.) 259 S. W. 970. But see *Pederson v. Christopherson* (1906) 97 Minn. 491, 106 N. W. 958. "Indeed it is probable that some element either of ratification or of estoppel is at the root of most cases, if not all, in which an election of remedies, once made, is viewed as a finality." Cardozo, J., in *Schenck v. State Line Tel. Co.* (1924) 238 N. Y. 308, 312, 144 N. E. 592, 593.

be implied. As Professor Hine has pointed out,[14] the estoppel theory which seems to mean, simply, that the plaintiff's later resort to an inconsistent remedy must not be so unfair to the defendant as to amount to a fraud on him, breaks down the doctrine of election by depriving it of an excuse for a separate existence in our law. The doctrine is further broken down by a restriction on the court's statement regarding election by judgment: it is now generally held that a judgment that the plaintiff has not the remedy he seeks is not an election.[15] If the judgment is that the plaintiff has mistaken his rights, he may seek an inconsistent remedy. With these two qualifications, the rule announced in this decision is a fairly modern one. It is submitted, however, that a proper application of it to the facts of the present case would have produced a different result.

Taking the rule at its face value, we must find loss to the defendants or gain by the plaintiffs. The court found this in the temporary injunction restraining the defendants from disposing of the property. The opinion reads, "To deprive one of the free control of his property and the right to alien or incumber the same is to deprive him of a substantial right."[16] The answer would seem to be threefold. 1. The defendants were fully protected by their injunction bond. The purpose of the bond was to save them harmless. Should they be able to prevent any enforcement of the plaintiffs' rights on the ground of some problematical loss when the law had already fully protected them against any loss which it would recognize? 2. The defendants, if they suffered any loss in this case, suffered it as a result of their own fraud. Should they be heard to complain if their unsocial conduct caused them temporary inconvenience? In *McMahan v. McMahon*[17] the defendant urged in bar of a suit for breach of contract that he had been prevented for five months from disposing of his property by the plaintiff's earlier suit for specific performance of the same contract. The court held the defendant had nobody but himself to blame, saying, "Is the plaintiff to be penalized for that condition of affairs rather than the defendant, who brought it about by violating a valid contract?" 3. Recent cases in many jurisdictions show that as long as statutes allowing dismissal without prejudice exist, the loss pleaded by the defendant must be something more than an inconvenience or expense normally incidental to the defense of an earlier suit.[18] To hold otherwise is on such facts as these

[14] *Op. cit. supra* note 1, at p. 708.

[15] *Jadwin v. Hoyt* (1924, C. C. A. 7th) 1 Fed. (2d) 784; *Schenck v. State Line Tel. Co. supra* note 13; and see *Gunderson v. Halvorson* (1918) 140 Minn. 292, 168 N. W. 8; *Palmer v. Bizzell* (1921, Tex. Civ. App.) 229 S. W. 971.

[16] At p. 499, 144 N. E. 304.

[17] (1922) 122 S. C. 336, 115 S. E. 293.

[18] *Carson v. Greeley, supra* note 2 (in rescission suit later dismissed the plaintiff restrained the defendant from disposing of the property; more than a year later she sued for damages on the same facts); *Brown v. Ball* (1919) 43 N. D. 314, 174 N. W. 629 (defendant arrested in earlier suit and forced to stand

to nullify those statutes. In this case the provisional injunction may not have been essential to the plaintiff's action for damages, but it certainly was normally incidental to it, and we should probably think the plaintiffs ill-advised if they had not applied for a restraining order. If they had not applied for it, but had merely subjected the defendants to costs beyond the taxable amount, the Ohio court would have seen no loss on the defendants' part. How can we draw the line between these two types of inconvenience, both incidental to the defense of such an action as this?

There seems to be little reason, then, for deciding that the original defendants had suffered such detriment that the plaintiffs had elected their remedy against them. Nor is there more reason for discovering an election against Frederickson, their grantee. He has sustained no loss. The plaintiffs have wrested no advantage from him. He did not come into the case until the injunction against his grantors had been dissolved.[19] If we assume that he had succeeded to the legal relations of his grantors though he had knowledge of the plaintiffs' rights, the plaintiffs have caused him no loss, because, as we have seen, they have caused his grantors none.

The other element the court requires for an election is inconsistent remedies. Assuming the defendants suffered detriment here, were the remedies sought so inconsistent that resort to one would bar the other? Since the plaintiffs brought only one action against Frederickson, it is difficult to see how they could have asked inconsistent remedies against him. But if we presume that he took the rights of his grantors, the question is then whether, although perhaps inconsistent at common law,[20] an action for damages, an injunction and a receiver with an averment that the legal title is in the defendants is under the code inconsistent with an action for the declaration of a trust and other relief. The court says that one is an action at law and the other a bill in equity.

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appeal of order vacating arrest); *Lewis v. Powell* (1918, Tex. Civ. App.) 205 S. W. 737 (expenses of setting aside earlier sale held not loss); *Navajo-Apache Bank & Trust Co. v. Desmont* (1918) 19 Ariz. 335, 170 Pac. 798 (plaintiff successively brought and dismissed, before finally suing for an accounting, actions to restrain the sale of property, to replevy it, and to recover damages for its conversion); *Mansfield v. Pickwick Stages, Northern Div., Inc.* (1923) 191 Calif. 129, 215 Pac. 389 (expense of preparing motion for change of venue held not loss). See also *McMahan v. McMahon, supra* note 17; *Cowan v. Young* (1920) 282 Mo. 36, 220 S. W. 869; *Freeman v. Fehr* (1916) 132 Minn. 384, 157 N. W. 587.

[19] *Cf. Roullard v. Rosenberg Bros. & Co., supra* note 13; *Crutcher v. Eaves, supra* note 13.

[20] "It is apparent that the measure of consistency required of a litigant in any jurisdiction must depend a good deal on the character of its rules of procedure. The doctrine of election is inherited from the inexorable logic of the formulary system of the common law. Modern procedure, more or less libellary in character, sacrifices consistency so far as is necessary to the attainment of substantial justice." Beach, J., in *Abbadessa v. Puglisi, supra* note 1.

It is only necessary to reply that under the codes there is but one civil action. No inconsistency can now be predicated on ancient inconsistencies between law and equity, because under the reformed procedure "law" and "equity" do not exist. What then is the inconsistency between these two suits? Had the plaintiffs brought the same suit again they could have amended the averment of title in their complaint. As was said in *Columbus Mut. Life Ins. Co. v. National Life Ins. Co.*,[21] a case not noticed by the court, "Under the provisions of our Code equitable and legal actions may now be united in a single suit. Since the cause of action was not changed by the plaintiff in the court below, plaintiff had a perfect right to amend the prayer of its petition so that it might ask for damages only." Do the differences in the form of relief demanded make the actions inconsistent? Aside from the obvious points of resemblance between the two prayers, it may be observed that few rules are better established in code pleading than that the prayer for relief is immaterial.[22] If the plaintiffs had brought the same suit, they could have amended their demand without difficulty. If they could bring another action for damages, and then amend the averment of title and the prayer for relief so that the complaint in that action was identical with that in their present suit, why should they not be permitted to accomplish the same result directly, that is by bringing their present suit? They seek in their present action just what they could have sought by the more tedious and expensive process of filing their former complaint and then amending it.

The doctrine of election of remedies was once a mere mechanical contrivance designed to shut off litigation. Great efforts have been made, and are made in the decision here commented on, to place it on higher ground. The aim is to prevent a defendant from being unjustly subjected to repeated suits. It would seem that the estoppel theory gives most hope of reaching that result without jeopardizing the rights of plaintiffs. The dangers of requiring less than estoppel are indicated by this case. Here, through the application of another rule, the intent of the codifiers that relief should be granted on the facts proved was defeated and recovery to defrauded plaintiffs was denied.

RIPARIAN PRIVILEGE OF POLLUTION

In the recent case of *Penn. R. R. v. Sagamore Coal Co.* (1924, Pa.) 126 Atl. 386, the Supreme Court of Pennsylvania granted an injunction restraining the defendants from discharging mine waters into a stream from which the plaintiffs, railroad and water companies, drew their

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[21] (1919) 100 Ohio St. 208, 125 N. E. 664.

[22] *Smith v. Smith* (1903) 67 Kan. 841, 73 Pac. 56; *Grand Island Savings & Loan Assoc. v. Moore* (1894) 40 Neb. 686, 59 N. W. 115; Pomeroy, *Code Remedies* (4th ed. 1904) secs. 11-13.

water supply. The defendant, relying on *Penn. Coal Co. v. Sanderson*,[1] contended that the privilege of pollution was a property right which could not be taken from them except by condemnation. In that case the defendant riparian was permitted to pump water out of its mine on to the land whence it might find its way into the stream even though it destroyed all the fish in the plaintiff's pond, rendered the water unfit for use, and so corroded the plaintiff's pipes and machinery as to make them worthless. This was judicial legislation based upon the supposed general welfare and public interest as those exist in a coal mining state like Pennsylvania. Although the character of user was in both cases the same, the court termed the user in the instant case a "public nuisance," as the parties here complaining were not private individuals but public service companies.

Ownership of land on the banks of a stream gives rise to certain legal relations which are termed "riparian rights."[2] Thus a lower riparian has a right that upper riparians restrict their use of the stream to domestic[3] or reasonable industrial[4] uses, and a right that non-riparians

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[1] (1886) 113 Pa. 126, 6 Atl. 453.

[2] *French-Glenn Live Stock Co. v. Springer* (1899) 35 Or. 312, 58 Pac. 102; *S. O. & C. Co. v. Ansonia Water Co.* (1910) 83 Conn. 611, 78 Atl. 432. A non-riparian does not acquire riparian rights by acquiring a license from a riparian to convey water to his residence. *Stoner v. Patten* (1909) 132 Ga. 178, 63 S. E. 897. It has been held that a municipality situated on the banks of a stream may supply its inhabitants whether or not their lots border the stream. *City of Canton v. Shock* (1902) 66 Ohio St. 19, 63 N. E. 600; *contra: Stock v. Hillsdale* (1909) 155 Mich. 375, 119 N. W. 435; *New Whatcom v. Fairhaven Land Co.* (1901) 24 Wash. 493, 64 Pac. 735. See 1 Tiffany, *Real Property* (2d ed. 1920) 1138; and see *Osborn v. Norwalk* (1905) 77 Conn. 663, 60 Atl. 645, where a municipality bought a tract on a stream beyond its corporate limits. Ownership of land on navigable streams gives rise to legal relations similar to those accorded a riparian on a non-navigable stream; but there can be no interference with the rights of navigation. See *Morrill v. Water Power Co.* (1879) 26 Minn. 222, 2 N. W. 842; 1 Farnham, *Water and Water Rights* (1904) 289.

[3] A riparian proprietor may even go so far as to exhaust the supply of water when his use is limited to the so-called "domestic" purposes (such as household needs, watering of stock, etc.). *Miner v. Gilmour* (1858) 12 Moore, P. C. 131; see *Lone Tree Ditch Co. v. Cyclone Ditch Co.* (1910) 26 S. D. 307, 128 N. W. 596; 1 Tiffany, *op. cit. supra* note 2, at p. 1133; *cf. Broadmoor Dairy & Live Stock Co. v. Brookside Water & Improvement Co.* (1897) 24 Colo. 541, 52 Pac. 792. For an attacking view see NOTES (1910) 10 COL. L. REV. 65; 2 Farnham, *op. cit. supra* note 2, at p. 1578.

[4] Industrial purposes are secondary to domestic uses. *Auburn v. Union Water Power Co.* (1897) 90 Me. 576, 38 Atl. 561. User must be reasonable under the circumstances so as not to infringe upon like privileges of other riparians. *Lawrie v. Silsby* (1909) 82 Vt. 505, 74 Atl. 94; *Pennsylvania R. R. v. Miller* (1886) 112 Pa. 34, 3 Atl. 780; *Lux v. Haggin* (1884, Calif.) 4 Pac. 919; *Mentone Irr. Co. v. Redlands Electric Light & Power Co.* (1909) 155 Calif. 323, 100 Pac. 1082; *Mason v. Whitney* (1906) 193 Mass. 152, 78 N. E. 881. If one diverts water from a channel for manufacturing purposes, his user is unreasonable if he causes diminution of flow by not returning that which he does not actually consume. *Weiss v. Oregon Iron & Steel Co.* (1886) 13 Or. 496, 11 Pac. 255.

in no way interfere with his privilege of user.[5] Upper riparians, on the other hand, have privileges of reasonable user,[6] one of which is the privilege of reasonable pollution. In *John Young & Co. v. Bankier Distillery Co.*[7] the defendant was restrained from pumping mine water into the stream, which, though pure, rendered the water hard and thus less suitable for use in the plaintiff's distillery. In *Sandusky Portland Cement Co. v. Dixon Pure Ice Co.*[8] the defendant used the water in its factory and returned it so heated that it raised the temperature of the stream at the plaintiff's land about one-half a degree, thus interfering with the latter's ice business. Such use was regarded as an unreasonable addition of a foreign element and an injunction was granted. Yet in *Helfrich v. Catonsville Water Co.*[9] it was held that the fouling of water above the plaintiff's reservoir by the defendant's cattle gave rise to no right of action, even though the water was thus made unfit for drinking. If the damage done is slight, no injunction will be issued and the only recourse is for damages.[10] It is obvious that no rule of thumb can be laid down to fit all cases of industrial pollution.[11] "Reasonable-

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[5] There are a number of cases which permit a riparian to assign his riparian rights to a non-riparian. *St. Anthony Falls Water Power Co. v. Minneapolis* (1889) 41 Minn. 270, 43 N. W. 56; *Lawrie v. Silsby, supra* note 4; *cf. Doremus v. Patterson* (1913) 65 N. J. Eq. 711, 55 Atl. 304. But the contrary view seems more widespread. See 1 Tiffany, *op. cit. supra* note 2, at p. 1150; NOTES (1904) 4 COL. L. REV. 431; (1902) 16 HARV. L. REV. 145. A riparian may not divert the water for use on a non-riparian tract. *Hopkinsville Bank v. Western Kentucky Asylum for Insane* (1900) 108 Ky. 357, 56 S. W. 525; *Crawford Co. v. Hathaway* (1903) 67 Neb. 325, 93 N. W. 781. Purchase of a parcel of land on a stream does not give a town the privilege to divert water for use of inhabitants on non-riparian land. *Gordonsville v. Zinn* (1921) 129 Va. 542, 106 S. E. 508. For a complete discussion and list of cases, see 14 A. L. R. 330, note.

[6] See *supra* notes 3 and 4. A non-riparian cannot complain of pollution. *City of Newcastle v. Harvey* (1913) 54 Ind. App. 243, 102 N. E. 878. In some of the western states the doctrine of prior appropriation of water is applied, but this is generally restricted to irrigation. *Jones v. Adams* (1885) 19 Nev. 78, 6 Pac. 442; *Offield v. Ish* (1899) 21 Wash. 277, 57 Pac. 809. The doctrine has also been applied in the case of mining operations. *Krall v. United States* (1897, C. C. A. 9th) 79 Fed. 241. For an extensive treatment, see Wiel, *"Priority" in Western Water Law* (1909) 18 YALE LAW JOURNAL, 189; (1914) 27 HARV. L. REV. 530; (1915) 3 CALIF. L. REV. 460; see 1 Tiffany, *op. cit. supra* note 2, at p. 1156.

[7] [1893, H. L.] A. C. 691.

[8] (1915, C. C. A. 7th) 221 Fed. 200.

[9] (1891) 74 Md. 269, 22 Atl. 72.

[10] *Clifton Iron Co. v. Dye* (1889) 87 Ala. 468, 6 So. 192; 1 Farnham, *op. cit. supra* note 2, at p. 1701.

[11] Pollution for mining operations was held unreasonable in the following: *People v. Gold Run Ditch & Mining Co.* (1884) 66 Calif. 138, 4 Pac. 1152; *Sutter County v. Nichols* (1908) 152 Calif. 688, 93 Pac. 872; *Provolt v. Bailey* (1912) 62 Or. 58, 121 Pac. 961; see *Hill v. Standard Mining Co.* (1906) 12 Idaho, 223, 85 Pac. 907; 10 Ann. Cas. 587, note; Ann. Cas. 1913 D, 1082, note; 22 L. R. A. (N. S.) 280. To permit such pollution would be taking property

ness" varies directly with the interests of the community, the size and

without compensation. *Woodruff v. North Bloomfield Gravel Mining Co.* (1884, C. C. D. Calif.) 18 Fed. 753.

Unreasonable pollution by factories: *Humphreys Tunnel & Mining Co. v. Frank* (1909) 46 Colo. 524, 105 Pac. 1093 (poisonous waste matter); *Horton v. Fulton* (1908) 130 Ga. 466, 60 S. E. 1059 (sawdust); *Worthen & Aldrich v. White Spring Paper Co.* (1908) 74 N. J. Eq. 647, 70 Atl. 468 (waste fiber and discoloration); *Merrifield v. Lombard* (1866, Mass.) 13 Allen, 16 (chemicals); *H. B. Bowling Coal Co. v. Ruffner* (1906) 117 Tenn. 180, 100 S. W. 116 (chemicals); *Tipping v. Eckersley* (1855, Ch.) 2 Kay & J. 264 (heat); *Shoffner v. Sutherland* (1910) 111 Va. 298, 68 S. E. 996 (sawdust); see *American Tar Products Co. v. Jones* (1920) 17 Ala. App. 481, 86 So. 113; 1 Tiffany, *op. cit. supra* note 2, at p. 1143.

Unreasonable discharge of sewage: *Platt Bros. & Co. v. City of Waterbury* (1907) 80 Conn. 179, 67 Atl. 508; *Mann v. Willey* (1900, 3d Dept.) 51 App. Div. 169, 64 N. Y. Supp. 589; *Vogt v. City of Grinnell* (1907) 133 Iowa, 363, 110 N. W. 603; *Markwardt v. City of Guthrie* (1907) 18 Okla. 32, 90 Pac. 26; *Lowe v. Ottaray Mills* (1913) 93 S. C. 420, 77 S. E. 135; see Liessmann, *Stream Water Rights in Illinois* (1912) 6 ILL. L. REV. 382 at 387; 41 L. R. A. 751, 753.

Unreasonable miscellaneous uses: *Bowman v. Humphrey* (1906) 132 Iowa, 234, 109 N. W. 714 (dairy refuse); *Adams v. Clover Hill Farms* (1917) 86 Or. 140, 167 Pac. 1015 (dairy refuse); *Barton v. Union Cattle Co.* (1889) 28 Neb. 350, 44 N. W. 454 (cattle pens); *People v. Elk River Mill Co.* (1895) 107 Calif. 214, 40 Pac. 486 (stable); *Durango v. Chapman* (1900) 27 Colo. 169, 60 Pac. 635 (slaughterhouse). But the following were held reasonable: *McEvoy v. Taylor* (1909) 56 Wash. 357, 105 Pac. 851 (reasonable number of cattle pastured); *People v. Hulbert* (1902) 131 Mich. 156, 91 N. W. 211 (bathing); *Barnard v. Shirley* (1897) 151 Ind. 160, 47 N. E. 671 (baths at sanitarium).

It makes no difference whether or not the lower proprietor bought with knowledge of the pollution. *Virginia Hot Springs Co. v. Grose* (1907) 106 Va. 476, 56 S. E. 222. It is also immaterial that pure water may be procured from another source. *Stevenson v. Ebervale Coal Co.* (1902) 203 Pa. 316, 52 Atl. 201. Doubtless the court would have considered this very material in "balancing the conveniences" had this been an action for an injunction rather than merely for damages.

The privileges of a municipality are no greater than those of an individual. *Watson v. New Milford* (1900) 72 Conn. 561, 45 Atl. 167; *Doremus v. Patterson, supra* note 5; see *Robb v. La Grange* (1895) 158 Ill. 21, 42 N. E. 77; 47 L. R. A. (N. S.) 137, note. Of course a municipality may acquire greater privileges by exercising its power to condemn for public purposes.

When the pollution becomes a "public nuisance" the privilege ceases and an injunction will be granted in suit by the state. *Com. v. Kennedy* (1913) 240 Pa. 214, 87 Atl. 605. Or on suit by an individual who has suffered special damage. *Hoyt v. McLaughlin* (1911) 250 Ill. 442, 95 N. E. 464; *Arizona Copper Co. v. Gillespie* (1913) 230 U. S. 46, 33 Sup. Ct. 1004. An individual may also recover damages. *Kraver v. Smith* (1915) 164 Ky. 674, 177 S. W. 286; *Platt Bros. & Co. v. Waterbury, supra.* The privilege to pollute more than is ordinarily reasonable may be acquired by prescription. *Jones v. Crow* (1859) 32 Pa. 398; *Masonic Temple Assoc. v. Harris* (1887) 79 Me. 250, 9 Atl. 737; see *Brookline v. Mackintosh* (1882) 133 Mass. 215; 1 Farnham, *op. cit. supra* note 2, at p. 1706; Ann. Cas. 1912 C, 182, note. But not so as to a "public nuisance," *Kraver v. Smith, supra; Attorney General v. Grand Rapids* (1913) 175 Mich. 503, 141 N. W. 890.

nature of the stream, custom and usage, and the reaction of the court in the particular case.[12]

The *Sanderson* case held that a pollution, practically the same in character as that in the instant case, was privileged as against a single riparian proprietor severely damaged. Would that decision have been otherwise if *all* the lower proprietors had joined the plaintiff in his suit? It seems not and that the theory of the case was that the defendant therein was legally privileged to pollute the stream as against all riparian owners alike. A *dictum* in that case[13] did indicate, however, that the pollution might become a "nuisance" to the public and that in such a case the privilege would cease. It was on that *dictum* that the court in the instant case relied. But the attachment of the appellation "public nuisance" to a user has hitherto been regarded as dependent not upon the plurality of parties complaining of individual special damage, but rather on the general damage common to all.[14]

The present decision probably carries the rule of the *dictum* in the *Sanderson* case farther than was intended, but the Pennsylvania court has already indicated[15] that the actual decision in that case was not to be extended, and that it was ripe for limitation. It was once thought that the only public advantage of a public user of water over a private user lies in the power to take by condemnation. The present case holds in effect that the privilege of user is less as against public users of water than it is as against private users. This also may be a sound distinction; but there lies in it the possibility of taking property without compensation. However that may be, the further limitation of the rule in the *Sanderson* case should be welcomed, and we may expect its total abandonment eventually.

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[12] In *Penn. Coal Co. v. Sanderson* (1886) 133 Pa. at p. 149, 6 Atl. at p. 459, Clark, J., said: "To encourage the development of the great natural resources of a country, trifling inconveniences to particular persons must sometimes give way to the necessities of a great community." See Bohlen, *The Rule in Rylands v. Fletcher* (1911) 59 U. Pa. L. Rev. 298, at p. 381; *Mason v. Whitney* (1906) 193 Mass. 152, 78 N. E. 881; *Strobel v. Kerr Salt Co.* (1900) 164 N. Y. 303, 58 N. E. 142; *Driscoll v. American Hide & Leather Co.* (1918, Sup. Ct.) 102 Misc. 612, 170 N. Y. Supp. 121; *cf. Beach v. Sterling Iron & Zinc Co.* (1895) 54 N. J. Eq. 65, 33 Atl. 286.

[13] "We do not say that a case may not arise in which a stream, from such pollution, may be regarded as a public nuisance, and that the public interest. . . may not require the abatement of that nuisance." 113 Pa. at p. 149, 6 Atl. at p. 459.

[14] *King v. Morris & Essex Ry.* (1867) 18 N. J. Eq. 397; *Smith v. City of Sedalia* (1899) 152 Mo. 283, 53 S. W. 907; see Wood, *Law of Nuisances* (1875) 29.

[15] *Com. v. Russell* (1896) 172 Pa. 506, 33 Atl. 709; *Com. v. Emmers* (1908) 221 Pa. 298, 70 Atl. 762.